Supreme Court, U. S.
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IN THE

Supreme Court of the United States

No. 77-114

OCTOBER TERM, 1977

WILLIAM J. QUIRK and LEON E. WEIN,
Appellants,

v.

MUNICIPAL ASSISTANCE CORPORATION for the City of New York and THE CITY OF NEW YORK,
Appellees.

On Appeal From The Court Of Appeals Of New York

JURISDICTIONAL STATEMENT

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ON APPEAL FROM THE COURT OF APPEALS OF NEW YORK

JURISDICTIONAL STATEMENT

Appellants appeal from the judgment of the Court of Appeals of New York, entered on April 26, 1977, affirming the decision of the Supreme Court of New York, Kings County, Special Term, and submit this Statement to show that the Supreme Court of the United States has jurisdiction of the appeal and that substantial federal questions are presented.

OPINIONS BELOW

The decision and opinion of the Court of Appeals of New York is reported at 41 N.Y. 2d 644 (1977) but is set forth in Appendix A hereto at pages A1-A6. The decision and opinion of the Supreme Court of New York Special Term, Kings County 1977 is not reported but is set forth in Appendix A hereto at pages A4-A6.

JURISDICTION

Appellants initiated this action in the Supreme Court of New York, Kings County, pursuant to Section 3001 of the New York CPLR, seeking a declaration that Chapters 168 and 169 of the Laws of New York of 1975 contravened the Contract Clause of the United States Constitution. Chapters 168 and 169 diverted the New York City Sales Tax and Stock Transfer Tax from the general revenues of New York City, where they provided security for the full faith and credit bonds of the City of New York, to a newly created corporation, the Municipal Assistance Corporation for the City of New York. The Constitution of the State of New York specifically provides that a bondholder may secure a court order directing the Comptroller to "set apart from the first revenues thereafter received" a sufficient sum to pay interest and principal on City Bonds. N.Y. CONST. Art. VIII §2. Defendant MAC has issued $4.4 billion of purported securities in violation of the Federal Constitution. Between June 10, 1975 and June 30, 1976 MAC has received $644 million of Sales Tax revenues which lawfully provide security for City bonds. Present projections of MAC annual debt service show that $780 million will be needed in fiscal 1980. MAC PROSPECTUS of June 14, 1977 at F-11.

The Supreme Court of New York, Kings County entered an order on March 10, 1977 dismissing the Appellants' Complaint and declaring that Chapters 168 and 169 are constitutionally valid. Appellants appealed that decision directly to tne Court of Appeals of New York which, on April 26, 1977, affirmed the lower court's judgment, *per curiam*. The Notice of Appeal was timely filed in the Supreme Court of New York, Kings County on May 20, 1977.

Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257 (2) this being an appeal from a final judgment

of the Court of Appeals of New York, the highest court of that State, holding that Chapters 168 and 169 of the 1975 Laws of New York are not repugnant as to Article I, Section 10, Clause 1, of the United States Constitution.

Questions Presented

1.

Is the New York legislation creating MAC and authorizing it to issue $4.4 billion dollars of purported securities without regard to the constitutional standards governing local government debt repugnant to Article 1, Section 10, Clause 1 of the United States Constitution on the ground that such legislation impaired an obligation of contract?

2.

Is the 1975 New York legislation repealing the New York City Sales Tax and renaming and reenacting it as the "New York State Sales Tax for the Benefit of New York City" and diverting it to the Municipal Assistance Corporation (MAC) repugnant to Article I, Section 10, Clause 1 of the United States Constitution on the ground that such legislation impaired an obligation of contract?

3.

Is the 1975 New York legislation creating MAC and diverting to it the New York City Stock Transfer Tax repugnant to Article I Section 10 Clause 1 of the United States Constitution on the ground that such legislation impaired an obligation of contract?

4.

Is the New York legislation creating MAC to fund operating deficits an impairment of New York City's contract with its bondholders which requires the City to operate within the confines of a balanced budget?

CONSTITUTIONAL and STATUTORY PROVISIONS INVOLVED

The Constitutional provision which Appellants contend has been violated by the diversion of City taxes to the newly created MAC is Article I, Section 10, Clause 1 of the United States Constitution, commonly known as the "Contract Clause," which provides in part as follows:

> "No State shall . . . pass any . . . Law impairing the obligation of Contracts . . ."

This case also involves 1975 New York Laws, chapters 168 and 169 which created MAC and the New York Constitution, Article VIII.

Statement of the Case

Appellants instituted this action on their own behalf as holders of the full faith and credit bonds of the City of New York. The action seeks declaratory judgment that chapters 168 and 169, which unilaterally deprive City bondholders of their security, violate the United States Constitution. The purchasers of New York City bonds relied upon the fiscal safeguards built into the 1938 State Constitution. Article VIII of the State Constitution specifies many bondholder protections. Bondholders have believed that only lawful debt could be issued. That is, that any debt issued on behalf of the City would comply with the State Constitution. However, none of the MAC debt meets the State constitutional standards. The State Constitution requires that long term debt may only be issued for capital projects. But MAC bonds may be issued to pay operating expenses. The State Constitution requires that short-term debt (one year notes) may only be issued in anticipation of taxes and revenues. But MAC may borrow in anticipation of a deficit. The legitimate expectations of the City bondholders, that any debt issued on behalf of the City would comply with the State Constitution, have been denied. The bondholders contend that this denial is an impermissible impairment of their contract in violation of the Federal Constitution.

The legal fiction purporting to justify MAC is that the State constitutional provisions only refer to cities; they do not refer to dummy corporations funded with taxes and borrowing on behalf of a city. Consequently, the dummy corporation is said to be free of all constitutional restraints. The Court of Appeals of New York so held below and in *Wein v. City of New York*, 36 N.Y. 2d 610 (1975) (Chief Judge Breitel and Judges Jasen and Jones dissenting). The City bondholders here contend that the creation of a dummy corporation, MAC, free of all state restraints, is an impairment of their contract under the Federal Constitution. The City bondholders contend that a term of their contract is that all debt issued on behalf of the City must comply with the State constitutional standards governing local finances. The State legislation creating MAC impairs the City bondholder's contract.

By means of MAC some $4.4 billion of invalid and unlawful debt has been issued. MAC has provided a vehicle for continued deficit financing by New York City. MAC was created for the sole function of borrowing money on behalf of the City of New York. MAC has no purpose, function or capacity other than the evasion of constitutional limitations.

The major bondholder safeguards, evaded by the

creation of MAC, and which evasion materially alters the risk of default for City bonds, may be noted as follows:

1. **City Debt Limit**—The New York Constitution, since 1884, has provided that no City could incur debt in excess of 10 percent of the value of its taxable real estate. N.Y. CONST. Art. VIII, §4. The purpose of this provision was to prevent the City "from improvidently contracting debts ... and to minimize the mischievous consequences to the taxpayers of extravagance in City expenditures." *Levy v. McClellan*, 196 N.Y. 178, 199, (1909). The City's own figures show a remaining debt margin within the general debt limit of $1,697,759,426. CITY OFFICIAL STATEMENT DATED JULY 1, 1976 as of DECEMBER 1, 1975. Plainly, the issuance of $4.4 billion of MAC bonds on behalf of the City puts the City approximately $2.7 billion over its debt limit. The debt limit, designed to prevent the City from incurring excessive debt, is consequently made meaningless by the legislative creation of MAC. The City bondholders had a legitimate expectation that the debt limit provision would be enforced. Instead, the provision has been evaded by the invention of a dummy corporation. The City bondholder's security has been impaired.

2. **City Can Only Borrow Long-term for Capital Projects**—The New York Constitution provides that the City can only issue its long-term debt, its bond, for capital projects. N.Y. CONST. Art. VIII §2. Day to day operating expenses must be paid from taxes or other revenues. A long-term borrowing was permissible only if the benefits would extend to future years. Of course, deficit financing was illegal. The provisions require a prudent system for City finances. However, the

State legislature, by the creation of MAC, has set up a dummy corporation to borrow for any purpose including the funding of a deficit. This disastrous fiscal approach endangers the City bondholder. Again, the bondholder had a legitimate expectation that the prohibition against deficit financing would be enforced not evaded. His security is impaired by the evasion.

3. **City Can Only Borrow Short-term in Anticipation of Revenues or Taxes**—The State Constitution provides that the City can only issue its short-term debt, other than bond anticipation notes, in anticipation of revenues and taxes due within one year. N.Y. CONST. Art. VIII §5. The short-term debt is junior to the City bonds. N.Y. CONST. Art. VIII §2. Short-term debt was thought to be fiscally prudent because of the requirement that it could be issued only in anticipation of real taxes or revenues. As long as that requirement was adhered to, the short-term debt could not be used to fund a deficit. The City bondholder, although senior to the noteholders, had the legitimate expectation that only lawful junior debt be issued. The State legislature, however, by the creation of MAC, authorized a dummy corporation to borrow on behalf of the City without respect to future revenues or taxes. The City bondholder's security is impaired by the legislative destruction of the limitations on City borrowing.

4. **Maximum Maturity**—The State Constitution limits the maturity of bonds to the probable useful life of the project. N.Y. CONST. Art. VIII §2. Further, in no event can the maturity extend beyond forty years. The fiscally sound premise of these provisions is that it is necessary to limit the

term of outstanding bonds to restrain interest cost. The State legislature, by the creation of MAC, has invented a dummy corporation which could issue 100 year bonds on behalf of the City. The City bondholders are entitled to have the term limitations enforced.

5. **Provision for Repayment**—The State Constitution requires that prompt provision be made for the repayment of principal. N.Y. CONST. Art. VIII §2. The City cannot borrow on an "interest only" basis. Its bonds must be either serial or backed by a sinking fund. Generally the first principal payment must be made within two years of the borrowing. Further, it is required that the principal payments be paid at an even rate. That is, payment must be made under a schedule in which no annual installment of principal is more than 50 percent greater than the smallest prior installment. The bondholder is protected by these prudent restraints on the borrowing power. The State legislature, by the creation of MAC, has invented a dummy corporation which could issue bonds on an "interest only" basis. The City bondholders are entitled to have the provision for the prompt repayment of principal enforced.

6. **City Pledge of Faith and Credit**—Since 1938, the Constitution has required that all City debt "shall have pledged its faith and credit". N.Y. CONST. Art. VIII §2. The provision was intended to prohibit limited liability obligations—such as those which would be issued by dummy corporation—where repayment was supposed to be restricted to a particular revenue source. Limited liability debt was considered unwise since the debt was incurred without full consideration because of the protection of the limitation. And yet, if trouble

came, as a practical matter, the limitation would not hold and the debt would have to be paid out of general taxes. The State constitutional requirement that the City pledge its faith and credit provides for clear and unequivocal commitments. The City's full resources stand behind the debt. The provision protects the bondholders since it prohibits the creation of dummy corporations funded with particular City taxes. The bondholders are entitled to enforcement of the provision prohibiting the creation of dummy corporations.

7. **Prohibition of City Liability on Public Corporation Bonds**—Article X, Section 5 of the State Constitution was added in 1938 to deal with the specific problem of "moral obligation" debt. In *Williamsburg Savings Bank v. State*, 243 N.Y. 231, (1926) the Court of Appeals held the State legally liable because of the "moral obligation" resulting from the creation of a River District although the bonds were issued without liability on the part of the State beyond specified assessments. The Court believed that the State was too involved to deny liability since the obligations "in essence and equity are its own". 243 N.Y. at 245-246. The decision raised the question whether behind "the authority stands, therefore, an implied liability of the government creating it." REPORT OF THE CONSTITUTIONAL CONVENTION COMMISSION TO THE 1938 CONVENTION, TAXATION & FINANCE at 356. The Convention thereafter determined that governmental debt and authority debt should be kept totally separate. The decision was made that the authority debtholders could have recourse only to their project. There was to be no implied governmental liability or bail-out

of the authority. The Convention voted after a speech by Delegate George Fearon.*

Following Mr. Fearon's speech the Convention adopted Article X Section 5 of the State Constitution which provides:

Neither the state nor any political subdivision thereof shall at any time be liable for the payment of any obligations issued by a public corporation heretofore or hereafter created, nor may the legislature accept, authorize acceptance or impose such liability upon the state or any political subdivision thereof.

Article X, Section 5 prohibits the creation of dummy corporations. Any public corporation

*Fearon stated

This comes right down to the question of whether or not you are going to protect the credit of the State, whether you are going to protect the credit of the municipal subdivisions of the State, or whether you are going to give these authorities an absolutely wide open hand and let them go out and spend money in any manner in which they please, issue bonds to any extent to which they can get those bond attorneys to pass them and these underwriting concerns to take them, because they are relying on the proposition that if the revenues of the enterprise are not sufficient to meet the interest and amortization, they can always go to the Legislature and ask for an enabling act and get the Legislature to say in effect that the full faith and credit of the State is in back of it.

I believe that when people buy these bonds they should know definitely and certainly that the credit of the State of New York and that the credit of the municipality is not behind those bonds. There should not be any question about it. That is the honest, fair, square way of doing business, and that is the kind of language that I understand. If they want to buy them under those circumstances, well and good, but let us not have them buy those bonds and then come back to the Legislature and say: "Well, there has been a precedent established in this State under the Williamsburg case. You did it in the Williamsburg case, and have got to do it for us. You have got to bail us out." It is not the fair, square, honest way of doing it.

1938 CONSTITUTIONAL CONVENTION RECORD AT 2276.

BEST COPY AVAILABLE

created must be able to stand on its own feet. Its debt cannot be supported, or paid, with tax funds. The City bondholders relied on Article X, Section 5 to bar the use of dummies. The provision prohibited the payment of City funds for authority debt. The State legislature, by constitution, was prohibited from imposing any such liability upon the City. Nonetheless, the State legislature, by the creation of MAC has directed that City tax revenues be funneled for the payment of dummy corporation debt. The MAC debt, which now purports to be a claim on the bondholders' revenues, could not exist if Article X, Section 5 had been obeyed. This material change in the bondholders risk is an impermissible impairment.

8. **Prohibition on Gift Or Loan of City Credit in Aid of a Public Corporation**—Since 1938 the Constitution has prohibited the gift or loan of City credit in aid of a public corporation. N.Y. CONST. Art. VIII §1. The Constitution permits a gift or loan of money on hand to a public corporation. However, a gift or loan of credit, the City's promise to pay, is prohibited. The 1938 draftsmen, in forbidding the use of local government credit in aid of a public corporation, stated:

The committees feel that it is essential to prevent any impairment of local credit on which the solvency and, indeed, the whole financial structure of our local governments are founded.

Report of the Committees on State Finances and Revenues, Cities, Counties and Towns, and Villages, JOURNAL OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF NEW YORK 1938, App. 3, Doc. No. 6 at 2.

In substance, of course, the City's credit, its tax revenues, are the only thing behind MAC bonds. Certainly it cannot be denied that New York City bondholders have relied upon the constitutional prohibition on the use of local governmental credit in aid of a public corporation such as MAC. Diversion of sales tax revenues to the payment of MAC's bonds rather than New York City bonds impairs the solvency of New York City and unilaterally changes the risks associated with the ownership of City bonds.

9. **City Balanced Budget**—The City pays its bonds and conducts the business of government within the limitations of a statutory scheme which directs that expenditures will not exceed its revenues. It is the general revenues of the City which secures the City's bonds. Other than the real estate tax, any tax may be altered from time to time or repealed. But the altered or repealed tax must be replaced with a new tax or revenue. The budget must be in balance. It is the most plain impairment, with the budget about $1.5 billion in deficit, to transfer the almost $1 billion Sales Tax to a dummy corporation.

10. **Bondholders First Lien**—Since 1938 the City bondholders have been entitled to a first lien on all City revenues. N.Y. CONST. Art. VIII §2. If the City failed to appropriate debt service, the Comptroller was directed to make such payment from "the first revenues thereafter received". A bondholder could sue to compel the Comptroller to do so. With MAC the legislature has taken a major City tax, the Sales Tax, and given it to a new corporation. The Sales Tax is then said to be a State Tax, not a City revenue, and consequently not subject to the City bondholder's lien. The first

> lien provision was the bondholder's critical security. It established the bond, by Constitution, as the City's senior security. Short term revenue and tax anticipation notes are junior since they are not eligible for the first lien provision unless they are "not retired within five years after their date of original issue."

The "first lien" provision on the City's revenues was a major inducement to potential investors. In the Notice of Sale of $141,440,000.00 of Serial Bonds of the City of New York dated February 15, 1975 and prepared by the Comptroller, it was stated that: "Payment of debt service shall be a first lien on all of the City's revenues." (at p. 2)

The same Notice of Sale stated that if the City failed to appropriate debt service:

> " . . . a sufficient sum shall be set apart from the first revenues thereafter received and shall be applied for such purposes; also, that the fiscal officer of the City may be required to set apart and apply such revenues as aforesaid at the suit of any holder of such obligations." (at p. 2)

Page 7 of the Comptroller's Official Statement contains a chart entitled "Local Non-Property Taxes" which shows estimated budget receipts of $2,197,200,000. for 1974-75. Of this amount the City Sales Tax contributed $813,800,000. Nowhere in the Comptroller's Statement was there any indication that these revenues could be removed from the bondholder's lien by the simple expedient of renaming the City Sales Tax the New York State Sales Tax for the Benefit of New York City.

In 1974 the City issued a phamphlet entitled "Ten Good Reasons for Investing in Tax Exempt Bonds of the

City of New York." Reason Number 3, captioned "First and Prior Lien", stated:

> Holders of New York City Bonds have first and prior lien on all City revenues, including the tax yield from $79 billion in full valuation of real property (up from $38 billion in 1963-64): Total receipts of the City—exceeding $10 billion annually—are more than nine times the amount needed for debt service on the City's funded debt now outstanding.

On November 7, 1974 Mayor Beame and Comptroller Goldin wrote a letter to the New York Times, published November 11, which was run under the caption "New York City: The Sound Investment." Said the authors:

> It should be clear, in connection with our municipal budget, that the Constitution of the State of New York makes our New York City bonds and notes a first lien on all revenues—which include the real estate tax, all other city taxes, fees and permits, all state aid and all Federal aid. *New York Times*, November 11, 1974 at 23 col. 5.

In the spring of 1975 the City of New York was without cash or credit. Moreover, as Summer approached, it had falling due short term notes as follows:

June 11, 1975—$187 million of Tax Anticipation Notes

June 11, 1975—$315 million of Tax Anticipation Notes

June 11, 1975—$250 million of Revenue Anticipation Notes

June 25, 1975—$248.9 million of Bond Anticipation Notes

June 30, 1975—$400 million of Revenue Anticipation Notes

August 22, 1975—$141 million of Bond Anticipation Notes

September 15, 1975—$400 million of Revenue Anticipation Notes

TOTAL $2,542 billion of short term debt due between June 11 and September 15, 1975.

The holders of the short term debt due between June 11 and September 15, 1975 will be hereinafter referred to as the "SUMMER NOTEHOLDERS". These notes were issued in denominations of $25,000. to $100,000.

The City of New York was unable to borrow. The state legislature created a new corporation, MAC. MAC was given the City Sales Tax, told to go and borrow money on it, and then turn the money over to the City that was unable to borrow. The City could then pay the short term notes that were falling due.

The Court of Appeals of New York in the opinion below summarized the MAC legislation as follows:

> . . . The New York City sales tax was suspended, and an identical sales tax was imposed by the State, with the revenues to be committed to MAC (L 1975 Ch. 168, §§4, 7-a). This suspension of the city tax was to continue until all obligations of MAC had been repaid (L 1975 ch. 168, §4). In addition, to the extent necessary to enable MAC to meet its obligations and carry on its corporate purposes, MAC was to receive appropriations from the stock transfer tax fund (L 1975, ch. 168, 7-b). Appendix at A1-A2.

The creation of MAC permitted a solution of the City Crisis that was cost free to the State. No state money was needed. No state taxes were required. No use of the state's

credit was needed. The City had lost its credit. But the City continued to collect taxes, the sales tax and stock transfer tax brought in about $1 billion a year. The State's solution was to take that stream of revenues from the City and place it in a new corporation, MAC. The new corporation, with revenues of $1 billion, and no expenses, was thought easily to be able to borrow enough to pay off the SUMMER NOTEHOLDERS. There was also no cost to the City, it could continue with its deficit financing.

On June 10, 1975 the Governor approved Chapters 168 and 169 of the Laws of 1975 effective immediately. The laws created defendant Municipal Assistance Corporation for the City of New York which was described as a "corporate governmental agency and instrumentality of the state constituting a public benefit corporation."(§3033). Its purpose, according to the statute, was to "assist the city" and create "investor confidence." (§3031). The legislature stated that the City was unable to borrow "due to a general decline in investor acceptance of local government securities and to almost unprecedented interest rates." (§3002). The legislature further found that some cities "despite the financial soundness of their obligations" have recently faced difficulty in selling their debt. (Id.)

The Secretary of the Treasury has testified that "New York City has run operating deficits each year since fiscal year 1961. By fiscal year 1975, these deficits totalled over $4 billion." Testimony of Secretary William E. Simon, Hearings-Oversight on the New York City Seasonal Financing Act, to Committee on Banking, Housing and Urban Affairs, United States Senate, 94th Cong. 2d Sess. (April, 1976) at p. 17. Further, the Secretary has testified that the City had an operating budget deficit, in 1975-75, of $1.542 billion (including "Expense Bonds") and, in 1976-77, of $1.275 billion (including "Expense Bonds"). Testimony of Secretary William E. Simon, Hearings-Oversight on New York City Loan Program, to Committee

on Banking, Housing and Urban Affairs, United States Senate, 94th Cong. 2d Sess. (December, 1976) at p. 8-9.

The June, 1975 legislation authorized MAC to borrow $3,000,000,000. at such interest rates as it could negotiate (§3033). The original purpose of MAC, as explained by state officials to the press, was to "pay off the $3 billion of the city's short term debt that falls due between now and Labor Day" *New York Times*, June 6, 1975 at p. 1 col. 8. It was expected that the City could return to the credit market on its own in October, 1975. *New York Times*, June 12, 1975 at p. 52 col. 1.

MAC was unable to accomplish its purpose. The initial $1 billion of MAC bonds offered in July 1975 was sold only with great difficulty. In August, an intended sale of $1 billion had to be cut back to $275 million. The September intended sale of $1 billion was called off.

In view of the failure of MAC the State felt constrained to adopt other policies in September. First, the legislature created the New York City Emergency Financial Control Board and granted it powers to control the City's finances. L. 1975 ch. 868, §2 as amended by L. 1975 ch. 869 and L. 1975 ch. 870. Second, the State undertook to borrow $750 million on its own credit and turn the proceeds over to the City. L. 1975 ch. 868, §22, 23 as amended by L. 1975 ch. 870. Third, the legislature enacted a stay law. L. 1975 ch. 868 §19 as amended by L. 1975 ch. 870.

The stay law added a new Title 6-A to the Local Finance Law. Title 6-A purported to alter constitutional rights. According to the Constitution, Article VIII, Section 2, a City bondholder may bring an action to require a set aside of the "first revenues thereafter received" if the City fails to make an annual appropriation for payment of his debt. According to the new statute a bondholder may not maintain an action unless "payment" by the City is "due or overdue." (§85.10). Further, even after nonpayment, the law imposed a new condition precedent on the City bond-

holder. He is required, prior to bringing any action, to serve a demand for payment on the City and then wait for 30 days. (§85.10). During the waiting period, the City or the Control Board is authorized to file a voluntary petition in court reciting that the City is unable to pay its debts as they mature. (§85.30). The filing of the action acts as an automatic stay to all actions and proceedings. (§85.30). The stay may remain in place for an indefinite time. The City is required to file a "repayment plan" within 90 days, or such additional time as the court, after a hearing, may allow, during which time the stay continues. (§85.30). The court, after a hearing, may approve the filed plan (§85.40). If approved, the court shall extend the stay "for such additional period of time as is required to carry out fully all the terms and provisions of the plan." (§85.40) The plan is to provide that creditors, including bondholders, be paid as promptly "as is practicable under the circumstances" after "giving due regard to the financial condition of the municipality and to the necessity for the municipality to expend moneys to maintain and provide services." (§85.40). Provision is also made for amended and modified plans and further stays. (§85.40 and §85.60).

On November 14, 1975 the legislature enacted the Moratorium Act. L. 1975, ch. 874 as amended by L. 1975 ch. 875. The Act extended for three years the maturities on $1.6 billion of publicly held short term notes. Instead of payment the noteholders were given the option of exchanging their notes for 10 year 8 percent MAC bonds or holding their notes which were by law extended to 1978 maturity and the interest thereon reduced to 6 percent. After two MAC exchange offers about $1 billion in notes remained in the public. On November 19, 1976 the Moratorium Act was held unconstitutional. *Flushing Nat.. Bank v. MAC*, 40 N.Y. 2d 731 (1976). The court relied solely on state constitutional grounds. The Federal Contract Clause cases, which had been argued by the parties,

were found by the Court to "cast little light" on the issues. 40 N.Y. 2d. at 740.

The so-called "rescue" effort has dramatically increased the City's debt burden and reduced the likelihood that the City bonds will be paid.

Pre-"Rescue"	**Bonds**	**Notes**	**Total**
June 30, 1974	$6.728	$3.421	$11.149 Billion

Post-"Rescue"	**Bonds**	**Notes**	**MAC**	**Total**
April 30, 1976	$7.495	$5.856	$3.809	$17.2 Billion
April 30, 1977	$7.932	$6.066	$4.362	$18.4 Billion*

Further it is fairly clear that by June 30, 1978, the end of the Three Year Financial Plan, the total will be around $21 Billion.

How The Federal Questions Were Rasied And Decided Below

Appellants in their complaint asserted that the existence of MAC and the diversion of the Sales and Stock Transfer Taxes as well as the failure to maintain a balanced budget impaired the contract of the City bondholder in violation of the Contract Clause of the United States Constitution.

The lower court held chapters 168 and 169 to be valid and constitutional. The court stated that a balanced budget was not a "term of the contract." (A-5)

The court entered an order granting defendants cross motions for summary judgment declaring chapters 168 and 169 valid and constitutional.

On appeal, the Court of Appeals affirmed the judgments below. The court found that there is no requirement "that the diverted taxes be continued directly payable to the city". (A). The City's "traditional source of

* CITY PROSPECTUS OF MAY 20, 1977 AT 56.

revenue" is the real estate tax and only it is constitutionally protected. (A-2). The court made no mention of the balanced budget requirement apparently agreeing with the lower court that the State and City are not required to maintain a balanced budget.

The Federal Questions Are Substantial

I

The judgment of the New York Court of Appeals presents the substantial question whether a State can set up a dummy corporation to deprive City bondholders of their security or whether such bondholders are protected by the Contract Clause of the United States Constitution.

This Court, in the *Port Authority* decision, held with respect to public contracts, that an "impairment may be constitutional if it is reasonable and necessary to serve an important public purpose." *United States Trust Co. v. New Jersey* U.S. 97 S. Ct. 1505, 1519, 52 L. Ed. 2d 92, 112 (1977) Or, as the Chief Justice wrote in his concurring opinion, "The State must demonstrate that the impairment was essential to the achievement of an important state purpose." U.S. at 97 S. Ct. at 1523; 52 L. Ed 2d at 116. This Court further found.

> In applying this standard, however, complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake. A governmental entity can always find a use for extra money, especially when taxes do not have to be raised. U.S. at ; 97 S. Ct at 1519-20; 52 L. Ed 2d at 112.

This case presents a far more extreme impairment than that struck down in the *Port Authority* case. The

analogy to the Port Authority situation would be if the States had transferred the George Washington Bridge, Lincoln Tunnel and Holland Tunnel to a new public corporation, the Port Authority Assistance Corporation, directed it to borrow on behalf of the Port Authority, (which used the proceeds to pay off a class of unsecured creditors), and informed the old Port Authority bondholders that their interest in the toll revenues was now subordinate to the new bonds issued by the Port Authority Assistance Corporation. Clearly, this Court would not uphold such an impairment. Indeed, summary reversal is appropriate in this case.

The New York Constitution's fiscal provisions are based upon sound economic principles. A City may issue bonds only for capital projects. A City's capacity to borrow, further, must be limited to prevent an undue burden on the future and bankruptcy. If a City borrows, it must pledge its full faith and credit—its commitment to pay must be clear and unambiguous so that the future burden may be understood. A City must have income to cover its expenses. Short-term borrowing must be in anticipation of real revenues or taxes. City funds may not be used to bail out an authority. If the City fails to appropriate debt service the bondholders have a first lien on the "first revenues thereafter received". The bondholders' reasonable expectations were that these state constitutional provisions would continue to be binding.

The constitutional pattern imposes fiscal limits for the benefit of the public and the bondholders.

The City bond is a general obligation instrument. No specific assets or taxes (other than the real estate tax) are pledged. The bondholder purchases with the expectation that other City debt may be issued. It may issue bonds for capital projects and within its ten percent debt limit. It may issue notes in anticipation of taxes and revenues due within one year. A later unlawful borrowing would, of course, impair the bondholders security.

The bondholder believes he is protected by the detailed constitutional provisions limiting when bonds and notes may be issued. Only as specified in the Constitution may the City incur any further burdens. Combined with the requirement of a balanced budget the bondholder believes he has a secure investment. If the Constitution is obeyed it is very unlikely that the City will get into trouble. If that unlikely event does occur the bondholder believes he is protected by the first lien provision requiring that "the first revenues thereafter received" be set aside for payment to bondholders. The Constitution provides a complete and coherent framework of protection for the bondholder.

But the New York legislature has turned the traditional constitutional pattern into a cruel hoax. The Constitution, according to the New York Court of Appeals, only limits the actions of cities. It does not refer to dummy corporations set up to borrow on behalf of the City and funded with City taxes. With this remarkable sleight of hand all of the bondholders protections are destroyed. The dummy corporation is not restrained by any of the constitutional provisions that bind government itself. It may borrow in excess of the City's debt limit. It may borrow to pay operating expenses. It may borrow to fund a deficit. The City's taxes may be relabeled and applied to the dummy's debt. The constitutional system is made meaningless. By means of this subterfuge some $4.4 billion of unlawful debt is imposed upon the City.

According to this current New York theory the Constitution binds the legislature only as long as it wishes to be bound. When it no longer wishes to be bound it may set up a dummy corporation which is free of all constitutional restrictions. The bondholder consequently becomes a speculator, hoping that the legislature will choose to comply with the Constitution. Obviously, no one would invest his money based on such a hope. If the alter-ego dummy corporation is free of constitutional restraints

the traditional municipal bond system must fail. New York has ignored the Constitution to reach its present predicament. Now, just as the bondholder's safeguards appear crucial, it seeks to withdraw them. Constitutional protection must not be treated with such cynicism.

The bondholders contract with New York provided that only two types of City debt could be issued: (1) bonds for capital projects and (2) notes in anticipation of taxes or revenues. The Constitution prescribed the necessary conditions for each of these lawful borrowings. The tremendous illegal borrowing incurred by MAC is an impairment of the City bondholders' security. MAC has permitted the City of New York to continue massive deficit financing and avoid fiscal reality. The likelihood that the City bonds will be paid becomes increasingly dim as the pile of debts goes even higher.

The MAC debt has been issued in violation of the Federal Constitution. As this Court has said:

> an unconstitutional act is not a law; it confers no rights; it imposes no duties; it affords no protection; it creates no protection; it creates no office; it is in legal contemplation, as inoperative as though it had never been passed. *Norton v. Shelby County*, 118 U.S. 425, 442, (1886).

II.

The existence and nature of a contract within the Contract Clause is a matter for this Court to decide.

Counsel for MAC has already assured the directors of MAC, and the press, that this Court will dismiss this appeal. The *New York Times* reports:

> The directors of the MAC heard their counsel, former Federal Judge Simon H. Rifkind, assure

> them that the court would probably not even bother to hear the appeal. *New York Times*, May 6, 1977 at B-6 col. 1.

MAC attorneys had earlier explained to the press why this Court would not hear this case. The *New York Times* reports:

> Attorneys for the M.A.C. said yesterday that "whether a particular set of facts constitutes a contract is a matter of state law, not Federal law," and that therefore they viewed the court decision as "definitive". *New York Times*, April 27, 1977 at 1, col. 1.

The attorneys for MAC are apparently unaware that this Court has repeatedly held that its jurisdiction was not so easily foreclosed. In *Coombes v. Getz*, 285 U.S. 434, 441 (1931) this Court reaffirmed a long line of authority as follows:

> The decision of the supreme court of a state construing and applying its own constitution and laws generally is binding upon this court; but that is not so where the contract clause of the Federal Constitution is involved. In that case this court will give careful and respectful consideration and all due weight to the adjudication of the state court, but will determine independently thereof whether there be a contract, the obligation of which is within the protection of the contract clause, and whether that obligation has been impaired; and, likewise, will determine for itself the meaning and application of state constitutional or statutory provisions said to create the contract or by which it is asserted an impairment has been effected.

See also *Jefferson Branch Bank v. Skelly*, 1 Black 436, 443 (1861); *Wright v. Nagle*, 101 U.S. 791, 793-94 (1879); *Louisville & Nashville R.R. Co. v. Palmes*, 109 U.S. 244, 256-57 (1883); *Louisville Gas Co. v. Citizens Gas Co.*, 115 U.S. 683, 697 (1885) and *Stearns v. Minnesota*, 179 U.S. 223, 232-33 (1900).

Counsel to MAC has further explained its position to the public in a *Letter to the Editor* of the *Wall Street Journal* published May 9, 1977. Counsel Rifkind concluded.

> The Port Authority decision does not affect the validity of the unanimous Court of Appeals decision upholding MAC. *Wall Street Journal*, May 9, 1977 at 23 col. 5.

Counsel to MAC observed that there was no contractual duty on "New York State to continue to impose a New York City sales tax." Id. The State, since it was under no obligation, could rename the tax and divert it to MAC.

In fact, of course, the State was simply depriving City bondholders of their exclusive remedy just as it appeared it would be needed. The State intentionally removed revenues from the bondholders' lien. This was done to give the State, cost-free, a revenue stream on which it could float a loan. In order to pay off the SUMMER NOTEHOLDERS, a junior security.

The State chose the MAC route because it was the only solution that was cost-free to the State. The State, with its great resources and credit, was easily able to assist its major city. Instead, it chose to avoid its responsibility and put all the cost onto the existing City bondholders. There were a whole range of policy alternatives: (1) the State could have imposed sufficient taxes; (2) the State could have borrowed on its general credit; and (3) the State could have passed a new tax and dedicated it to a new borrowing.

The first lien provision does not, of course, freeze the tax structure as of the date of the contract. The Constitution provides that the legislature shall not "restrict the power to levy taxes on real estate for the payment of interest or on principal of indebtedness theretofore contracted." N.Y. CONST., Art. VIII §2. But with that single exception, the legislature retains full power over taxation. Other than the real estate tax, any tax may be altered from time to time or repealed. The present case, however, does not involve repeal, it involves relabeling and diversion. It involves a preference—in violation of the constitutional priorities—to the SUMMER NOTEHOLDERS over the City bondholders. It is not a legitimate exercise of the power of taxation.

Further, the New York Constitution and City Charter (sections 116-128) require the City to maintain a balanced budget. Consequently, any tax may be altered or repealed but the altered or repealed tax must be replaced with a new tax or revenue. The budget must be in balance. It is the most plain impairment, with the budget about $1.5 billion in deficit, to transfer the almost $1 billion sales tax to a dummy corporation.

It should be clear to all that the City has not provided a balanced budget in 1975-76 and 1976-77. The New York City Financial Plan dated January 1976 forecast for the 1975-76 fiscal year revenue of $12,721,000,000. and expenses of $13,786,000,000. That Plan forecast for the 1976-77 fiscal year revenue of $12,991,000,000 and expenses of $13,978,000,000. Indeed, these figures understate the operating deficit since they include as revenue about $700 million (each year) of bond proceeds which were illegally issued to pay expenses rather than capital projects.

III.

It is of great importance to New York City bondholders that this Court restore constitutional principles within the State of New York.

The municipal bond was created by this Court in the post Civil-War period. In such cases as *Gelpcke v. Dubuque*, 68 U.S. (1 Wall.) 175 (1865) this Court went to great lengths to assure bondholders that certain fundamental unalterable principles did exist.

A long term debt requires a reasonably stable society. The state or city offer the investor the following contract: "If you will loan me a $1,000,000. of your money today I will promise to pay you 7% interest each year and, after 40 years, repay the $1,000,000. of principal." The due date, the year 2017, is far in the future. By traditional notions 40 years is the time of 2 generations. A great deal of change would be expected even in a fundamentally sound society. How then can the investor be induced to part with his money now in exchange for a promise of repayment in the distant future? He must believe that certain fundamental principles will be fixed and unchangeable.

In the *Municipal Bond* cases this Court created the legal framework to assure the investor. The bond must cease to be the province of the speculator and become the choice of the country's most prudent and conservative investors. Local government could then secure its needed funds at the lowest possible interest rate. This Court could not, of course, assure payment—a town might default. But it could assure that the terms of the obligation could not be changed.

When a state or city borrowed money it made a contract. Once the contract was made it was absolutely fixed. The Contract Clause would strike down any attempt at alteration.

The Contract Clause would fix the terms and conditions of the debt once made. The bondholders had only to negotiate favorable terms and they would have a legally secure investment. Of course, legal safeguards might not prevent a default. But, as a condition of the borrowing, the bondholders could insist on specific remedies in case of non-payment. They could provide, as does the New York Constitution, that in the event of a failure to appropriate the Comptroller shall "set apart from the first revenues thereafter received" a sufficient sum. N.Y. CONST. Art. VIII §2.

The financial community is well aware that only this Court can restore the municipal bond to its prior vitality. On August 11, 1976 the *Wall Street Journal* editorialized:

> There may be some short-term benefit for New York and a few other local authorities in giving local governments the power to abrogate their contracts with bondholders without benefit of official bankruptcy proceedings or any other judgment by a neutral third party. But it can only work to the detriment of public finance by the great bulk of local governments.
>
> * * *
>
> Perhaps it seems implausible that the Supreme Court would send the nation's largest city into bankruptcy because of a legal point like the sanctity of contract. But that legal point protects the investor when he lends his money to the state, and without it every governmental unit will suffer. *Wall Street Journal*, August 11, 1976 at 12 col. 1.

Similarly, following *United States Trust Company of New York v. New Jersey*, U.S. 97 S. Ct. 1505, 52 L. Ed 2d 92

(1977), the financial community looks to this case as a crucial test. On April 29, 1977, the *Wall Street Journal* editorialized:

> It remains to be seen where public contracts *can* be impaired, and the next crucial test will very likely be the appeal from Tuesday's New York State Court of Appeals decision upholding the validity of the Municipal Assistance Corporation.
> These future suits may be potentially more uncomfortable for New York than the Port Authority decision. The suit against MAC, which the present decision seems to strengthen, could entail the repudiation of billions in bonds and the bankruptcy of New York City. But the court is affirming a principle basic to this country's public finance. Even though the hypothetical consequences of its decision may be made to seem very grim, the alternative, to weaken the legal underpinnings of municipal bonds, would have been far worse. (emphasis in original). *Wall Street Journal*, April 29, 1977 at 12 col. 1.

There would, however, seem no reason for the city to go into bankruptcy. The MAC statute, section 3036 (4), provides that there "shall be annually appropriated and paid to the corporation" by the State any deficiency in the capital reserve fund. It would be expected that the State would honor its commitment to the MAC bondholders.

IV.

The Constitutional Priority of City Bonds Must Be Upheld.

Since 1938 the New York Constitution has required the City to make an annual appropriation for debt service on its bonds. The provision continues:

> "If at any time the respective appropriating authorities shall fail to make such appropriations, a sufficient sum shall be set apart from the *first revenues thereafter received and shall be applied to such purposes.* The fiscal officer of any county, city, town, village or school district may be required to set apart and apply *such revenues* as aforesaid at the suit of any holder of obligations issued for any such indebtedness." (emphasis added)

N.Y. CONST. Art. VIII, §2.

This provision is not applicable to City short-term notes unless they are unpaid for five years after issue. Id. See *Flushing Nat. Bank v. MAC*, 40 N.Y. 2d. 731, 737-38 (1976).

Prior to 1938 the essential bondholder protection was the unlimited real estate tax. The bondholder could mandamus the Tax Collecting officials to levy, collect and pay over the real estate tax. The Constitution made clear that there was no limitation as to rate or amount. Since 1884 the legislature has been limited in the amount of real estate taxes which it may authorize a city to impose. In New York City the normal tax limit provides that real estate taxes may not exceed 2.5% of the average full valuation of taxable real estate. N.Y. CONST. Art. VIII, §10. Amounts raised within the normal tax limit may be expended for any "city . . . purposes." The purpose of the tax limit is to limit the taxation of real estate for current operating ex-

penditures. In addition to the 2.5% tax limit the Constitution permits the levy of real estate taxes, in any amount, to provide "for the interest on and principal of all indebtedness." Id.

Consequently, a bondholder, or noteholder, could maintain an action based on Article VIII, section 10 of the Constitution to enforce collection of the real estate tax sufficient to pay his debt.

Until 1938 the bondholder's exclusive remedy was a mandamus action against the Tax Collecting officials to levy the real estate tax. During the depression the extreme inadequacy of this remedy became evident. This Court characterized it as "the empty right to litigate":

> The only remedy for the enforcement of such a claim is a mandamus to compel the levying of authorized taxes. The experience of the two modern periods of municipal defaults, after the depressions of '73 and '93, shows that the right to enforce claims against the city through mandamus is the empty right to litigate. *Faitoute Iron & Steel Co. v. Asbury Park*, 316 U.S. 502, 510, (1942).

The Court continued:

> there is no remedy when resort is had to devices and contrivances to nullify the taxing power which can be carried out only through authorized officials. See Rees v. Watertown, 19 Wall 107, 124. And so we have had the spectacle of taxing officials resigning from office in order to frustrate tax levies through mandamus, and officials running on a platform of willingness to go to jail rather than to enforce a tax levy (see Raymond, State and Municipal Bonds, 342, 343) and of evasion of

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> service by tax collectors, thus making impotent a court's mandate. Id. at 511.

This history was well known to the draftsmen of the 1938 Constitution. They also knew that a first lien provision applicable to State bonds, added to the Constitution in 1920, had been a success. They determined to adopt a similar provision applicable to local bodies. The Committees on State Finances and Revenues, Cities, Counties and Towns, and Villages explained the purpose as follows:

> The last paragraph of the section as proposed is adapted from Article VII, Section 11, which provides that if appropriation is not made by the State for its required debt service, the Comptroller shall set apart from the first revenues thereafter received a sum sufficient to meet such debt service and shall apply the moneys thus set apart. "The Comptroller may be required to set aside and apply such revenues as aforesaid, at the suit of any holder of such bonds." This section of the State Constitution has been of inestimable value in building up and maintaining the credit of the State, and a similar provision applicable to bonds issued on the full faith and credit of a locality will, the committees believe, have similar result. Sound credit not only results in lower interest rates and consequent saving to the taxpayers but assures the locality of the opportunity to issue obligations when it finds it necessary to do so.

JOURNAL OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF NEW YORK, 1938, App. 3, Doc. No. 6 at p. 3.

As noted the Report states that the local provision will be "applicable to bonds."

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The local first lien provision accomplished two objectives. First, by Constitution, the State surrendered the power to repudiate debt on behalf of a locality. *Meriwether v. Garrett*, 102 U.S. 497 (1880). Second, the local first lien provision replaces the "empty right to litigate" with a relatively simple means of enforcement. One that seemed as strong as the draftsmen could make it: (1) the bondholder did not have to wait for actual non-payment—the section was triggered by the failure to appropriate in the annual budget; (2) hopefully, the bondholder would not be required to bring an action—the provision imposed a constitutional duty on the Comptroller to "set apart from the first revenues thereafter received"; and (3) if the bondholder did have to bring an action it would be a fairly simple proceeding—against the Comptroller for a court order directing him to "set apart and apply such revenues as aforesaid."

The first lien provision, in its entirety, reads:

> **Provision shall be made annually by appropriation by every county, city, town, village and school district for the payment of interest on all indebtedness and for the amounts required for (a) the amortization and redemption of term bonds, sinking fund bonds and serial bonds, (b) the redemption of certificates or other evidence of indebtedness (except those issued in anticipation of the collection of taxes or other revenues, or renewals thereof, and which are described in paragraph A of section five of this article and those issued in anticipation of the receipt of the proceeds of the sale of bonds theretofore authorized) contracted to be paid in such year out of the tax levy or other revenues applicable to a reduction thereof, and (c) the redemption of certificates or other evidence of indebtedness issued in anticipation of**

> the collection of taxes or other revenues, or renewals, which are not retired within five years after their date of original issue. If at any time the respective appropriating authorities shall fail to make such appropriations, a sufficient sum *shall be set apart from the first revenues thereafter received* and shall be applied for such purposes. The fiscal officer of any county, city, town, village or school district may be required to set apart and apply *such revenues* as aforesaid at the suit of any holder of obligations issued for any such indebtedness. (emphasis added)

N.Y. CONST. Art. VIII §2.

The language "may be required to set apart" has been interpreted as mandatory in *Van Derzee v. City of Long Beach*. 265 App. Div. 1059 (2d Dept. 1943). The court ruled:

> In view of the mandatory provisions of the section in question, hardship is no defense to the payment of interest by the city of its indetedness to petitioner. The mandate of the Constitution must be obeyed. Id. at 1060.

It will be noted that Tax Anticipation Notes and Revenue Anticipation Notes are not eligible for the first lien unless they are "not retired within five years after their date of original issue."

The constitutional language "first revenues thereafter received" and "such revenues" is at issue in this case. Initially it may be noted that the Constitution refers to "revenues". The language does not limit the bondholder lien to "real estate taxes".

The first lien provision has been a primary selling point for New York City bonds. The security and commitment seemed absolute. The City must pay the bondholders first—before the police, fire and sanitation. Since these groups had to be paid to prevent anarchy a responsible government had to maintain sufficient revenues to meet debt service. This priority was protected by the Contract Clause of the Federal Constitution. Either a noteholder or bondholder could bring a mandamus to compel the levying of the unlimited real estate tax. The first lien, on the other hand, was exclusively a bondholder's protection. Notes are eligible for it only if they are unpaid for five years after issue.

But now comes MAC to argue that the first lien is an empty provision. MAC maintains that if there are no City "revenues" there is nothing for the bondholders lien to apply to. It seems startling to consider a City with no revenues, but, according to MAC, it is simple enough. The State has assigned City taxes to the newly created dummy corporation, MAC. The City Sales Tax was renamed and transferred to MAC. Then, MAC argues, the sales tax is not a City revenue and consequently not subject to the City bondholder's lien. According to MAC these revenues were removed from the bondholder's lien by the simple means of renaming the City Sales Tax the New York State Sales Tax for the benefit of New York City.

By this construction, the first lien provision was a trick played on bondholders. The State promised bondholders a lien on "revenues". But it retained the power to rename City Taxes as State Taxes and assign them to dummy corporations. The MAC interpretation is offensive to fair dealing and the respect we owe to the constitutional process.

Chapter 168, in purporting to transfer the City Sales Tax to MAC, is in violation of the Contract Clause of the Federal Constitution, Article I, Section 10.

V.

The court below failed to apply the precedent established by this Court.

The *MAC* case is not the first time that a state has acted to help a local government evade its obligations. This Court has decided a substantial body of cases dealing with repudiated promises. MAC considers these cases to be archaic. The New York court failed to apply these cases.

In *Von Hoffman v. Quincy*, 4 Wall. 535, (1866), the Illinois legislature had authorized the City of Quincy to borrow money and invest in railroad stock. The same act authorized a special annual tax upon real and personal property sufficient to pay the annual interest on such bonds. The tax, when collected, was to be set aside and used only for this purpose. The City failed to pay the interest coupons "a long time after they became due" and refused to levy the tax. Id. at 536. Von Hoffman recovered a judgment in 1863 which was returned unsatisfied. He then prayed for a writ of mandamus directing the City to levy the special tax. In 1863 the legislature enacted a new law limiting the City's power to tax. The new law repealed all existing statutes authorizing the imposition of taxes. The new law specified that the city could tax no more than (1) $.28 per $100 of value for gas lighting; (2) $.25 per $100 of value for education; and (3) $.50 per $100 of value for debt service and general expenses of the city.

The City answered Von Hoffman stating that the $.50 per $100 would not be sufficient to pay the city's expenses and debts. This Court found the 1863 repealing law to be invalid. It held:

> It is well settled that a State may disable itself by contract from exercising its taxing power in particular cases. New Jersey v. Wilson, 7 Cranch 164 (1812). It is equally clear that where a state has

> authorized a municipal corporation to contract and to exercise the power of local taxation to the extent necessary to meet its engagements, the power thus given cannot be withdrawn until the contract is satisfied. The State and the corporation, in such cases, are equally bound. The power given becomes a trust which the donor cannot annul, and which the donee is bound to execute; and neither the State nor the corporation can any more impair the obligation of the contract in this way than in any other. 4 Wall. at 554-555.

Mount Pleasant v. Beckwith, 100 U.S. 514 (1879) involved the debt of a municipal corporation which had been legislated out of existence and its territory annexed to other corporations. In 1853 the town of Racine issued $50,000 of its bonds in exchange for Railroad Company stock. In 1860 the Wisconsin legislature extinguished the town of Racine. Its territory was attached to the town of Mount Pleasant and the town of Caledonia. The act made "no provision . . . for the payment of the corporate debts." Id. at 517.

In 1873, Beckwith, a town of Racine bondholder, brought suit. The lower court held that the recipient towns took the territory subject to an "equitable liability" for the accrued indebtedness. Each town was consequently liable to Beckwith in proportion to the "taxable property received by each." Id. at 518. This Court affirmed.

This Court noted, "the constant practice is to divide large municipalities and to consolidate small ones, or set off portions of territory from one and annex it to another. Id. In making such alterations, the "legislature may apportion the common property and the common burdens," Id. If they fail to make provision the Court will apply certain general principles.

Mount Pleasant presents that issue in its most extreme form since the legislature had extinguished the debtor. This Court stated:

> In such a case, if no legislative arrangements are made, the effect of annulment and annexation will be that the two enlarged corporations will be entitled to all the public property and immunities of the one that ceases to exist and that they will become liable for all the legal debts contracted by her prior to the time when the annexation is carried into operation. 100 U.S. at 528.

It was further noted that:

> Text-writers concede almost unlimited power to the State legialature in respect to the division of towns and the alteration of their boundaries, but they all agree that in the exercise of these powers they cannot defeat nor impair the obligation of a valid contract. 100 U.S. at 533.

This Court observed that municipal debts are not paid by legislative acts repealing a charter. It concluded that the surviving towns became liable for the debt.

Mount Pleasant establishes the proposition that a State, having created a political entity and empowered it to borrow, may not annex its territory to another entity and diminish the revenues avilable to pay its debts, without making adequate provision for the payment of pre-existing debt. If the legislature does not make such provision, the courts will apportion the indebtedness among the resulting entities. Revenues, like land, may be annexed. The State having created a political entity and having empowered it

to borrow money may not annex revenues which were available for payment of its debts to another entity. Fiscal annexation is not permitted.

In 1885, another dissolved town case came to this Court. *Port of Mobile v. Watson*, 116 U.S. 289 (1885). *Port of Mobile* is quite similar to the present facts. The legislature attempted to make certain formal changes. This Court, however, looked to the substance.

The City of Mobile had issued $1 million of bonds to aid a railroad. A related ordinance provided for a special annual tax of $95,000. The bonds were issued in 1859 and matured in 1879.

However, in 1879, instead of paying the due bonds, the legislature dissolved the City of Mobile. A companion law incorporated a new city to be known as the Port of Mobile. The Port had about eight square miles while the old City had about seventeen. However, the Port included "all the thickly settled and closely built portion of the City." Id. at 300. Out of $16,000,000. of taxable property of the City, all but $900,000 was included within the Port. Further, fourteen-fifteenths of the population of the City were included within the Port.

This Court held that the Port was the successor in law of the former City and liable for its debts. The Contract Clause prohibited the withdrawal of the taxing power. The Court cited its earlier cases for the now well-established rule that:

> Therefore the remedies for the enforcement of such obligations assumed by a municipal corporation, which existed when the contract was made, must be left unimpaired by the legislature, or, if they are changed, a substantial equivalent must be provided. Where the resource for the payment of the bonds of a municipal corporation is the power of taxation existing when the bonds were issued,

any law which withdraws or limits the taxing power and leaves no adequate means for the payment of the bonds is forbidden by the Constitution of the United States, and is null and void. Id. at 305.

Port of Mobile is clear authority for the proposition that artificial, formal, alterations, such as the renaming of the Sales Tax, are not effectual to permit impairment of contractual obligations. Chapters 168 and 169 of the 1975 Laws of New York are null and void.

CONCLUSION

This Court should summarily reverse the judgment of the Court of Appeals of New York and find Chapters 168 and 169 of the Laws of New York of 1975 null and void in their entirety as in violation of the Contract Clause of the United States Constitution.

Respectfully submitted,

William J. Quirk
Leon E. Wein

Attorneys for Appellants

APPENDIX A

Decision of the Court of Appeals of New York

WILLIAM J. QUIRK et al., Appellants, v MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK et al., Respondents.

Argued March 31, 1977; decided April 26, 1977

Per Curiam. These cases present a very narrow issue. That issue is whether the State's "diversion" of the proceeds of the New York City sales tax and the tax on stock transfers from the general revenues of New York City to the Municipal Assistance Corporation unconstitutionally impairs the rights of city bondholders. Plaintiffs, holders of New York City longterm bonds, seek declatory judgments that the challenged diversion is unconstitutional. They appeal directly from summary judgments in favor of defendants granted by Supreme Court (see CPLR 3212; N.Y. CONST. Art VI, §3; CPLR 5601, subd [b], par. 2).

The summary judgments should be sustained. There is no requirement, either in the State Constitution or in any undertaking in the city bonds, that the diverted taxes be continued directly payable to the city. There is not, and never has been, an agreement, express or implied, that the revenues of these taxes be used to repay city bonds. Thus, since the challenged diversion does not impair any contractual obligations, the Federal Constitution is not violated (see U.S. CONST. Art. I, §10).

On June 10, 1975, by action of the State Legislature, the Municipal Assistance Corporation for the City of New York was created (L 1975, chs 168, 169; see *Flushing Nat. Bank v. Municipal Assistance Corp. for City of N.Y.*, 40 NY 2d 731, 733). To provide the new entity with a financial base, the New York City sales tax was suspended, and an

identical sales tax was imposed by the State, with the revenues to be committed to MAC (L 1975, ch. 168, '4, 7-a. This suspension of the city tax was to continue until all obligations of MAC had been repaid (L 1975, ch. 168, §4). In addition, to the extent necessary to enable MAC to meet its obligations and carry out its corporate purposes. MAC was to receive appropriations from the stock transfer tax fund (L 1975, ch. 168, §7-b). It is the diversion of these tax revenues, and no other portions of the applicable statutes, that plaintiffs challenge in this litigation.

Plaintiffs' contention is simply stated: the diversion of tax revenues from the city to MAC impairs the position of city bondholders, since fewer tax revenues will be available for repayment of principal and interest on city bonds. Therefore, the argument runs, the diversion is an impairment of contract in violation of the Federal Constitution (U.S. Const., Art. I, §10).

The answer to plaintiffs' contention is equally simply stated. In no way was the city ever committed to maintain sales tax revenues or stock transfer tax revenues for the benefit of its bondholders. That these taxes have been a substantial source of revenue for the city, in one instance since the 1930's and in the other since 1965, is of no consequence. What is important is that city bondholders are protected by the State Constitution, which obligates the city to appropriate moneys for the repayment of city bonds, and to exceed normal real estate tax limitations in order to raise the necessary moneys (N.Y. Const., Art. VIII, §2, 10, 12). In those provisions, which reflect the municipality's traditional source of revenue from its real estate tax levy, lies the constitutionally guaranteed protection of city bondholders.

Assuredly, the State Constitution provides that unpaid bondholders for whom moneys have not been appropriated are entitled to have sufficient sums for repayment "set apart from the first revenues thereafter received and

* * * applied to such purposes" (N.Y. Const. Art. VIII, §2). But this "first lien" on the city's revenues does not give bondholders the right to insist that any particular existing taxes be maintained or new ones imposed to produce those revenues. It only assures that out of the revenues which are collected, money must be provided to satisfy obligations to the bondholders.

On the other hand, with respect to the traditional real estate tax levies, the bondholders are constitutionally protected against an attempt by the State to deprive the city of those revenues to meet its obligations. Section 12 of article VIII of the State Constitution prohibits the Legislature from restricting the power of a locality "to levy taxes on real estate for the payment of interest on or principal of indebtedness theretofore contracted." This provision, combined with the city's pledge of faith and credit, constitutionally mandated in all municipal contracts of indebtedness, requires the city to raise real estate taxes, and without specification other revenues, if such a levy be necessary to repay indebtedness (N.Y. Const. Art. VIII, §2; *Flushing Nat. Bank v. Municipal Assistance Corp. for City of N.Y.*, 40 N.Y. 2d 731, 736-737, *supra*). The challenged statute does not, and could not, alter this obligation. A different case would be presented if, realistically, the city were stripped of all sources of revenue, other than the real estate tax, and its outcome would be, at this time, unpredictable (cf. *Mobile v Watson*, 116 U.S. 289, 305).

Plaintiffs' thesis rests on an untenable contention, namely, that city bondholders were entitled to rely on continued collection of the now diverted taxes. Nowhere, however, not in the State Constitution and not in the bonds themselves, is there any requirement that collection of particular taxes be continued. As a consequence, there is no impairment of obligation of contract under the Federal Constitution.

Accordingly, the judgments should be affirmed, without costs.

Chief Judge BREITEL and Judges JASEN, GABRIELLI, JONES, WACHTLER and COOKE concur in *Per Curiam* opinion; Judge FUCHSBERG taking no part.

In each case: Judgment affirmed.

Decision of the Supreme Court of New York, Kings County

Summary judgment is sought by plaintiffs, who bring this action as holders of bonds of the City of New York for a declaratory judgment that Chapters 168 and 169 of the Laws of 1975 of the State of New York, as amended, were enacted in violation of Article I, section 10, Clause 1 of the Constitution of the United States which provides, in pertinent part, that "no State shall . . . pass any . . . . Law impairing the Obligation of Contracts . . . "

The defendants, Municipal Assistance Corporation for the City of New York (hereinafter sometimes referred to as "MAC") and the City of New York, respectively, cross-move for summary judgment declaring Chapters 168 and 169 aforementioned to be valid and constitutional.

Specifically, plaintiffs challenge those provisions of Chapters 168 and 169 which suspend the authority of the City to impose a sales tax, impose a new state sales tax within the City, and provide for an annual appropriation of the proceeds of this tax as well as of the state stock transfer tax to MAC, to the extent necessary to pay on the bonds issued by MAC, an agency of the state.

The basic issues here raised have already been decided in favor of the constitutionality and validity of the challenged legislation (see, *Flushing National Bank v. City of New York*, Sup. N.Y., Korn, J., J.K.L.J., 12/5/73, p. 8; *Gilman v. Municipal Assistance Corporation* for the City of

New York, et al., Sup. N.Y., Ind. #1569/77, Korn, J., memo dec. dated 2/2/77). This court concurs in the views and reasoning expressed by Mr. Justice Korn in the above cited memorandum decisions. Plaintiffs at bar furnish no compelling grounds which would warrant, in this case, a departure from the conclusions reached in the above-cited cases as to the constitutionality and validity of the legislation in question.

Some comment, however, may be in order with respect to a contention advanced by plaintiffs in the case at bar which may not have been urged in the above-cited cases and which, in any event, was not dealt with in the memorandum decisions rendered in those cases, namely, that one of the terms of the contract between the defendant City and the plaintiffs, as purchasers of City bonds, was an obligation on the part of the City to maintain a balanced budget, and that the failure to provide a balanced budget constitutes an impairment of the obligations of the contract and a violation of the provisions of Article VIII, section 2, of the State Constitution.

This court finds no merit in the foregoing contention. Plaintiffs have not satisfied the court that a balanced budget was intended as, and was understood to be, a term of the contract of indebtedness represented by the City bonds held by plaintiffs.

As to plaintiffs' claim that the failure of the City to provide a balanced budget was a violation of the provisions of Article VIII, section 2, of the State Constitution, it is plain that what the plaintiffs as City bond holders are entitled to, as provided in said section, is a compliance by the City with the requirement that there shall be a sufficient sum appropriated annually by the City for the payment of interest on, and redemption of the City's bonds, and that if such appropriation is not made, there is to be set apart and applied to such purposes a sufficient sum from the first revenues thereafter received by the City. It is

plainly to be perceived that compliance by the City with the foregoing requirement does not necessitate a balanced budget. Indeed, the priority of payment accorded to the City's bond holders in said section suggests that the right of the bondholders to payment of interest and payment in redemption of the bonds can be satisfied without regard to whether the City's budget is in balance, where sufficient revenues are realized by the City out of which payment to the bondholders can be made. Thus, the alleged failure of the City to provide a balanced budget does not constitute an impairment of the obligations of the City's contract with its bondholders, nor is it violative of the provisions of Article VIII, section 2, of the State Constitution.

Plaintiffs' motion for summary judgment is denied and the respective motions of the defendant City and of defendant MAC for summary judgment declaring sections 167 and 168 of the Laws of 1975 to be valid and constitutional are granted.

Settle judgment.

J. S. C.

Appendix B

EXCERPTS FROM NEW YORK CITY AND NEW YORK STATE STATUTES

REPEAL OF NEW YORK CITY SALES TAX

(L. 1975 c. 168 §4)

(f) On the first day of the first month following the month in which a municipal assistance corporation is created under article ten of the public authorities law[1], any taxes imposed pursuant to this section by the city in aid of which such corporation was created and, except as hereinafter provided for in subdivision (h) *of this section, the power of such city to adopt and amend local laws, ordinances or resolutions imposing taxes pursuant to the authority of such section shall, notwithstanding any provision of article twenty-nine of this chapter[2] to the contrary, be suspended until all the notes and bonds of such municipal assistance corporation shall have been fully paid and discharged together with interest thereon and interest on unpaid installments of interest.*

IMPOSITIONS OF SALES TAX IN CITIES "OF ONE MILLION OR MORE".

(L. 1975 c. 168 §2)

§1107. *Temporary municipal assistance sales and compensating use taxes for cities of one million or more.*

(a) *General. On the first day of the first month following the month in which a municipal assistance corporation is created under article ten of the public authorities law*[1] for a city of one million or more, in addition to the taxes imposed by sections eleven hundred five and eleven hundred ten, there is hereby imposed on such

date, within the territorial limits of such city, and there shall be paid, additional taxes, at the rate of four percent, which except as provided in subdivision (b) of this section, shall be identical to the taxes imposed by sections eleven hundred five and eleven hundred ten. Such sections and the other sections of this article, including the definition and exemption provisions, shall apply for purposes of the taxes imposed by this section in the same manner and with the same force and effect as if the language of those sections had been incorporated in full into this section and had expressly referred to the taxes imposed by this section.

PAYMENT OF SALES TAX TO MAC
(L. 1975 c. 168 §7)

§92-d. *Municipal assistance tax fund*

1. There is hereby established in the custody of the comptroller a special fund to be known as the municipal assistance tax fund. Within such fund, there is hereby established a special account for each municipal assistance corporation created under article ten of the public authorities law.

2. Such fund shall consist of the revenues derived from municipal assistance sales and compensating use taxes imposed by sections eleven hundred seven and eleven hundred eight of the tax law.

* * *

6. Upon receipt by the comptroller of a certificate or certificates from the chairman of a municipal assistance corporation that such corporation requires a payment or payments in order to comply with any agreement with the holders of its notes and bonds and to carry out its corporate purposes, including the maintenance of the capital reserve fund, from the special account established for such corporation, each of which certificates shall specify the required payment or payments and the date when the payment or payments is required, the comptroller shall pay from such special account on or before the specified date or within thirty days after such receipt, whichever is later, to such corporation, as the chairman thereof may direct in any such certificate, the amounts or amounts so certified.

CREATION OF MAC
(L. 1975 c. 169)

§3033. *Creation of the municipal assistance corporation for the city of New York; authorized indebtedness*

1. There is hereby created the municipal assistance corporation for the city of New York. The corporation shall be a corporate governmental agency and instrumentality of the state constituting a public benefit corporation. It shall have the powers, privileges and duties of a corporation under title two of this article and under this title. The corporation shall continue for a term of one year after all its liabilities have been fully paid and discharged. Upon the termination of the existence of the corporation, all of its rights and property shall pass to and be vested in the state.

APPENDIX C

COURT OF APPEALS
State of New York

WILLIAM J. QUIRK and LEON EDWARD WEIN,

Plaintiffs-Appellants,

-against-

MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK and THE CITY OF NEW YORK,

Defendants-Respondents.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that WILLIAM J. QUIRK and LEON EDWARD WEIN, the appellants above-named, hereby appeal to the Supreme Court of the United States from the final judgment of the Court of Appeals of the State of New York, affirming the declaratory judgment of the Supreme Court of the State of New York that the provisions of Chapters 168 and 169 of the Laws of 1975 of the State of New York, as amended, are valid and constitutional and do not violate Art. I, § 10 of the Constitution of the United States, which judgment of the Court of

Appeals was entered herein on April 26, 1977.
This appeal is taken pursuant to 28 U.S.C. §1257 (2)

LEON EDWARD WEIN
Petitioner pro se and
Counsel for petitioners

FILED
'77 MAY 20, PM 2:08
Kings County Clerk's Office
FEE
RP